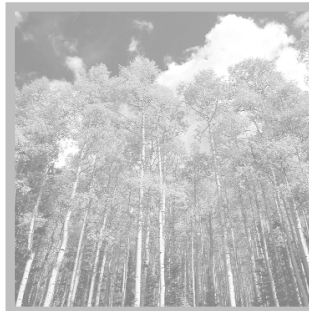


INTRODUCTORY



SECTION





State of Colorado



Bill Owens
Governor

Jeffrey M. Wells
Executive Director

Paul Farley
Deputy Executive Director

Richard Pennington
Division Director

Leslie M. Shenefelt
State Controller

DPA

**Department of Personnel
& Administration**

Division of Finance and Procurement

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December 23, 2004

To the Citizens, Governor, and Legislators of the State of Colorado

It is our privilege to present the Comprehensive Annual Financial Report (CAFR) on the operations of the State of Colorado for the fiscal year ended June 30, 2004. This report is prepared by the Office of the State Controller and is submitted as required by Section 24-30-204 of the Colorado Revised Statutes. The State Controller is responsible for managing the finances and financial affairs of the state and is committed to sound financial management and governmental accountability.

We believe the financial statements are fairly presented in all material aspects. They are presented in a manner designed to set forth the financial position, results of operations, and changes in net assets or fund balances of the major funds and nonmajor funds in the aggregate. All required disclosures have been included to assist the members of the General Assembly, the financial community, and the public in understanding the state's financial affairs.

Except as noted below, the basic financial statements contained in the CAFR are prepared in conformity with generally accepted accounting principles (GAAP) applicable to government as prescribed by the Governmental Accounting Standards Board (GASB), and except for certain blended component units and the discretely presented component units, they are audited by the State Auditor of Colorado. The basic financial statements comprise the Management Discussion and Analysis, financial statements, notes to the financial statements, and Required Supplementary Information. The schedules comparing budgeted to actual activity, included in the section titled Required Supplementary Information, are not presented in accordance with GAAP; rather, they reflect budgetary basis of accounting which defers certain payroll and Medicaid expenditures to the following fiscal year. In addition to the basic financial statements the CAFR includes: combining financial statements that present information by fund category; certain narrative information that describes the individual fund categories; supporting schedules; and statistical tables that present financial, economic, and demographic data about the state.

The funds and entities included in the CAFR are those for which the state is financially accountable based on criteria for defining the financial reporting entity as prescribed by GASB. The primary government is the legal entity that comprises the major and nonmajor funds of the state, its departments, agencies, and state funded institutions of higher education. It also includes certain university activities that are legally separate but have been blended with the accounts of the institution that is financially accountable for the activity.

The state's elected officials are financially accountable for other legally separate entities that qualify as discretely presented component units. The following entities are the discretely presented component units of the state:

University of Colorado Hospital Authority
Colorado Water Resources and Power Development Authority
Denver Metropolitan Major League Baseball Stadium District
University of Colorado Foundation
Colorado State University Foundation
Colorado School of Mines Foundation
University of Northern Colorado Foundation
CoverColorado

Additional information about these component units and other related entities is presented in Note 2 of the financial statements (see page 67). Audited financial reports are available from each of these entities.

PROFILE OF THE STATE OF COLORADO

Colorado became the thirty-eighth state of the United States of America when it was admitted to the union in 1876. Its borders encompass 104,247 square miles of the high plains and the Rocky Mountains with elevations ranging from 3,350 to 14,431 feet above sea level. The state's major economic sectors include agriculture, manufacturing, technology, tourism, energy production, and mining. Considerable economic activity is generated in support of these sectors by government, wholesale and retail trade, transportation, communications, public utilities, finance, insurance, real estate, and other services. Given the state's semi-arid climate, water resource development, allocation, and conservation are ongoing issues for state management.

The state maintains a separation of powers utilizing three branches of government – executive, legislative, and judicial. The executive branch comprises four major elected officials – Governor, State Treasurer, Attorney General, and Secretary of State. Most departments of the state report directly to the Governor; however, the Departments of Treasury, Law, and State report to their respective elected officials, and the Department of Education reports to the elected State Board of Education. The elected officials serve four-year terms with the number of terms limited in duration.

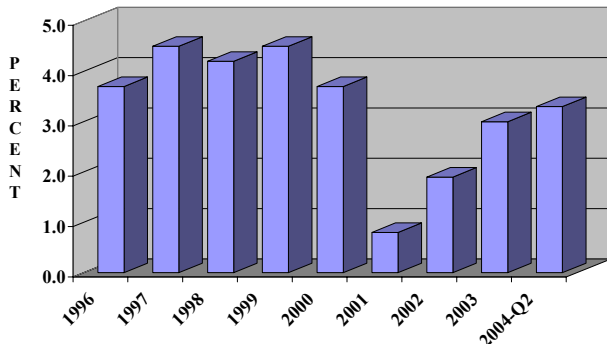
The Legislature is bicameral and comprises thirty-five senators and sixty-five representatives who are also term limited. It is a citizen legislature whose general session lasts 120 days beginning in January of each year. Special sessions may be called by the Governor at his discretion and are limited to the topics identified by the Governor. The Legislature's otherwise plenary power is checked by the requirement for the Governor's signature of its legislation and by specific limitations placed in the State Constitution by voters. The most significant fiscal limitation is the restriction related to issuing debt, raising taxes, and changing existing spending limits. From a fiscal perspective, the Joint Budget Committee of the Legislature, because of its preparation of the annual budget and supplemental appropriations bills, holds the most important power vested in the Legislature. The Committee is bipartisan with members drawn from each of the houses of the Legislature. The Governor's Office of State Planning and Budgeting develops an executive branch budget proposal, but there is no requirement for the Joint Budget Committee to adopt that proposal.

The Judicial Branch is responsible for resolving disputes within the state, including those between the executive and legislative branches of government, and for supervising offenders on probation. The branch includes the Supreme Court, Court of Appeals, and district and county courts, served by 256 justices and judges in 22 judicial districts across the state (excluding 17 Denver county court judges). Municipal courts are not part of the state system. There are also seven water courts, one in each of the major river basins. The Judicial Branch budget is appropriated by the Legislature, and it is funded primarily from general-purpose revenues of the General Fund.

ECONOMIC CONDITION AND OUTLOOK

After two years of declining revenues, the state's General Fund revenue picture rebounded slightly. General Fund revenues were \$289.5 million (5.3 percent) over the prior year amount; however, those revenues remained \$588.8 million (9.3 percent) below the Fiscal Year 2000-01 level. It was the first time in four years that the revised revenue forecast was higher than the original revenue forecast upon which the budget was prepared.

PERCENT CHANGE IN REAL GROSS DOMESTIC PRODUCT



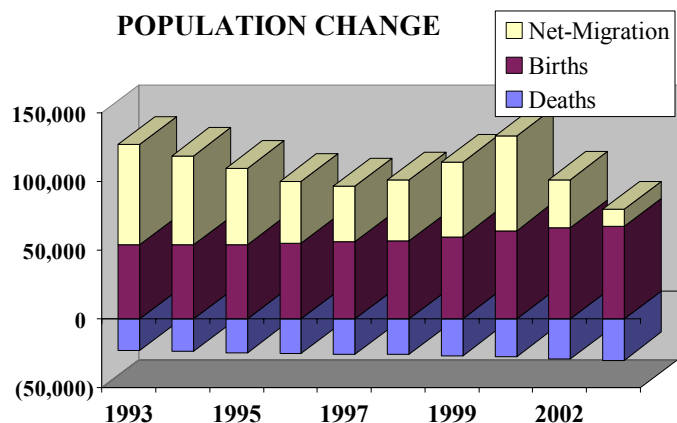
Although it started from a significantly reduced revenue base, the state's revenue growth began to parallel the national recovery that began in the fourth quarter of 2001. Inflation adjusted national gross domestic product grew at an annual rate of 3.0 percent in calendar 2003, and at 4.5 percent and 3.3 percent, respectively, in the first and second quarters of 2004. The major contributors to the increase in real GDP in the second quarter were nonresidential fixed investment (up 12.5 percent), personal consumption expenditures (up 1.6 percent), residential fixed investment (up 16.5 percent), private inventory investment (up .78 percent), and government spending (federal up 2.7 percent and state and local up 1.9 percent). Exports also contributed to the growth (up 7.3 percent) but were offset by an increase in imports (up 12.6 percent).

The growth in personal consumption expenditures, which accounts for two-thirds of GDP, was the lowest since the second quarter of 2002. The strong growth in residential fixed investments reflects improving labor markets, accelerating income growth, and low mortgage rates. Nonresidential fixed investment is currently driven by high returns on capital, good credit conditions, and healthy corporate balance sheets. Business investment's share of GDP is a historic low, indicating pent-up demand for new equipment and structures.

Inflation remains low with consumer prices up 2.5 percent year-to-date through August 2004. Productivity growth (up 2.5 percent) remains above the historic average and continues to mitigate inflation pressures and restrain job growth. Unemployment in August 2004 was 5.4 percent (down from 6.0 percent in 2003) – the lowest rate since September 2001. However, some question the validity of the unemployment statistic due to individuals dropping out of the work force. Nonagricultural employment for 2004 is forecast to remain below the 2001 peak.

Colorado's economic difficulties in Fiscal Year 2001-02 and 2002-03 affected net migration in calendar year 2003. Net in-migration declined from approximately 35,000 in 2002 to approximately 12,000 in 2003. However, the 2003 amount includes international in-migration of approximately 23,000 and out-migration to other states of nearly 11,000. This pattern likely results in replacing established households that have a high level of economic activity with new households that have a lower level of economic activity. The information in the adjacent chart is based on current Census Bureau estimates. Data for the year 2000 is not included in the chart because a large adjustment was made to total state population for that year, and matching annual estimates for deaths and births are not available for that year.

COMPONENTS OF COLORADO'S POPULATION CHANGE



Colorado's recent economic news has been mostly favorable. However, the Governor's Office of State Planning and Budgeting (OSPB) current forecast for Colorado reflects the deceleration of national economic activity. Following is the current OSPB forecast for Colorado's major economic variables:

- Employment growth will be above 0.8 percent in 2004, above 2.0 percent for 2005, and accelerate to 3.0 percent by 2008.
- Unemployment will average 5.3 percent in 2004, but may increase slightly due to previously discouraged workers returning to job searches. The rate is expected to fall to 4.2 percent by 2009.
- Wages and salary income will grow by 2.6 percent in 2004, 4.8 percent in 2005, and will be over 6.0 percent growth by 2007.
- Total personal income will increase by 3.2 percent in 2004 and exceed 6.0 percent growth by 2006, continuing through 2009.
- In-migration is expected to be slightly fewer than 10,000 in 2004. However, as the economy recovers, the state's population growth will reach 1.6 percent by 2008.
- The Denver-Boulder-Greeley price index will be virtually unchanged from 2003 resulting in a decline in the inflation rate from 1.1 percent to only 0.1 percent. A decline in shelter costs due to the large number of apartment vacancies, which accounts for one-third of total inflation, has held the rate down. Colorado inflation will increase slightly in 2005 to 1.5 percent and will be 2.1 percent by 2006.

MAJOR GOVERNMENT INITIATIVES

As in the two prior fiscal years, the establishment of new programs was limited because of the significantly lowered revenue base. As a result, much of the fiscal legislation that was passed was in reaction to existing financial problems rather than establishing new programs. Nonetheless, the following significant changes will affect the state's future fiscal operations.

Senate Bill 04-189 made several changes affecting the financing of higher education in Colorado. It established the College Opportunity Fund administered by the Colorado Student Loan Program. The fund will receive an annual appropriation from the state and will provide stipends at a fixed per-credit-hour rate to higher education institutions on behalf of eligible students attending state or participating private institutions. The bill authorizes the boards of state higher education institutions to designate their institutions as TABOR enterprises (See Note 8B) if they meet the TABOR enterprise requirements including receiving less than ten percent of annual revenues from state and local government grants. The Department of Higher Education is directed to enter fee-for-service contracts with state higher education institutions for a range of higher education services including basic skills courses, graduate school services, and specialized and professional degree services. The bill provides that revenues earned by higher education TABOR enterprises in the form of stipends from the College Opportunity Fund and from the Department under fee-for-service contracts are not to be counted as state grants in determining whether the institution has received more than ten percent of its revenue from state and local government grants.

House Bill 04-1021 lowered the blood alcohol level at which an individual is considered to be driving under influence of alcohol from 0.1 to 0.08 grams/milliliter. Lowering this limit allows the state to receive increased federal highway funds.

One House bill and two Senate bills made changes to the Certified Capital Company Act that provided insurance premium tax credits to insurance companies that invested in qualified small businesses within the state. One bill created a Venture Capital Authority to receive contributions from insurance companies and provide the funds to qualified businesses as seed and early-stage investment. The qualifications for receiving the investment funds were made more restrictive, but the insurance companies providing the funds continue to receive a credit on their premium taxes. Another bill provides a tax credit to insurance companies equal to the company's contribution to CoverColorado, a component unit of the state that provides medical insurance coverage that would otherwise be unavailable to citizens.

Multiple attempts were made to resolve the fiscal problems resulting from the combination of constitutional requirements associated with TABOR and Amendment 23. TABOR limits the amount of revenue the state may retain and spend while Amendment 23 mandates certain spending levels for primary education. Changing either TABOR or Amendment 23 requires a vote of the citizens, however, the legislature was unable to reach agreement on a ballot proposal.

BUDGETARY AND OTHER CONTROL SYSTEMS

The annual budget of the state for ongoing programs, except for federal and custodial funds, is enacted by the General Assembly. New programs are funded for the first time in the enabling legislation and continued through the Long Appropriations Act in future periods. For the most part, appropriations lapse at the end of the fiscal year unless extenuating circumstances prompt the State Controller to approve an appropriation rollforward. Capital construction appropriations are normally effective for three years.

The state records the budget in its accounting system along with federal awards and custodial funds of the various departments. Revenues and expenses/expenditures are accounted for on the basis used for the fund in which the budget is recorded except for certain budgetary basis exceptions (see Note RSI-1A). Encumbrances are also recorded and result in a reduction of the budgeted spending authority. Encumbrances represent the estimated amount of expenditures that will be incurred when outstanding purchase orders, contracts, or other commitments are fulfilled. Encumbrances in the General Fund are not reported as a reservation of fund balance unless the related appropriations are approved for rollforward to the subsequent fiscal year. Fund balance is reserved for encumbrances that represent legal or contractual obligations in the Capital Projects Fund and the Department of Transportation's portion of the Highway Users Tax Fund.

In developing the state's accounting system, consideration has been given to the adequacy of internal accounting controls. Internal accounting controls are designed to provide reasonable, but not absolute, assurance regarding the safeguarding of assets against loss from unauthorized use or disposition. Those controls also assure the reliability of financial records for preparing financial statements and maintaining the accountability for assets.

The concept of reasonable assurance recognizes that the cost of a control should not exceed the benefits likely to be derived from that control. The evaluation of costs and benefits requires estimates and judgments by management. All internal control evaluations occur within this framework. We believe that the state's internal accounting controls adequately safeguard assets and provide reasonable assurance of proper recording of financial transactions.

RISK MANAGEMENT

The state self-insures its agencies, officials, and employees against the risk of loss related to general liability, motor vehicle liability, and workers' compensation. Property claims are not self-insured, as the state has purchased insurance. The state uses the General Fund to account for the risk management function including operations and all current claims or judgments. (See Note 6-H on page 74, Note 22 on page 95, Note 26 on page 101). Actuarially determined and other long-term risk management claims are reported only on the government-wide *Statement of Net Assets*. Medical claims for officials and employees are managed through the Group Benefits Plan Fund, a Pension and Employee Benefits Trust Fund. The Regents of the University of Colorado are self-insured for workers' compensation, auto, general, and property liability. The Board of Governors of the Colorado State University System is self-insured for certain risks and participates in the state's risk management fund for other risks.

INDEPENDENT AUDIT

The State Auditor performs an audit of the Basic Financial Statements. The opinion of the auditor is on page 18 of this report. Besides auditing the statewide financial statements, the auditor will from time to time audit the financial statements and operations of various departments and institutions within state government.

In 1996, the United States Congress amended the Single Audit Act of 1984. The amended act clarifies the state's and the auditor's responsibility for ensuring that federal moneys are used and accounted for properly. Under the requirements of this act, transactions of major federal programs are tested. The state prepares a Schedule of Expenditures of Federal Awards for inclusion in the State Auditor's Statewide Single Audit Report. The State Auditor issues reports on the schedule, the financial statements, internal controls, and compliance with the requirements of federal assistance programs.

CASH MANAGEMENT

Statutes permit the State Treasurer to invest cash that is not immediately needed to pay obligations of the state. These investments may consist of obligations of the United States, commercial paper of prime quality, repurchase agreements, bank acceptance agreements, and other investment instruments. The State Treasurer also invests funds of the Colorado Water Resources and Power Development Authority, a component unit, and the Great Outdoors Colorado Trust Fund, a related organization. Both are accounted for in the treasurer's agency funds. At June 30, 2004, the State Treasurer held the following investments at fair value:

Investment Type	Amount in Millions
U.S. Government Securities	\$ 2,044.3
Corporate Bonds	1,029.0
Mortgages	588.1
Commercial Paper	787.0
Mutual Funds	224.4
Asset Backed Securities	402.2
Other	4.1
Total	<u>\$ 5,079.1</u>

Included above is \$1,416.6 million belonging to Pinnacol Assurance, a related organization for which the State Treasurer maintains in an individual Investment Trust Fund. The financial statements of that fund are included in this report.

CERTIFICATE OF ACHIEVEMENT

The Government Finance Officers Association of the United States and Canada (GFOA) awarded a Certificate of Achievement for Excellence in Financial Reporting to the State of Colorado for its comprehensive annual financial report for the fiscal year ended June 30, 2003. This was the seventh consecutive year that the government has achieved this prestigious award. In order to be awarded a Certificate of Achievement, a government must publish an easily readable and efficiently organized comprehensive annual financial report. This report must satisfy both generally accepted accounting principles and applicable legal requirements.

A Certificate of Achievement is valid for a period of one year only. We believe that our current comprehensive annual financial report continues to meet the Certificate of Achievement Program's requirements, and we are submitting it to the GFOA to determine its eligibility for another certificate.

ACKNOWLEDGMENTS

In conclusion, I thank my staff and the staffs of all the state departments and institutions whose time and dedication have made this report possible. I reaffirm our commitment to maintain the highest standards of accountability in financial reporting.

Sincerely,

A handwritten signature in cursive script, reading "Leslie M. Shenefelt".

Leslie M. Shenefelt
State Controller



Certificate of Achievement for Excellence in Financial Reporting

Presented to

State of Colorado

For its Comprehensive Annual
Financial Report
for the Fiscal Year Ended
June 30, 2003

A Certificate of Achievement for Excellence in Financial Reporting is presented by the Government Finance Officers Association of the United States and Canada to government units and public employee retirement systems whose comprehensive annual financial reports (CAFRs) achieve the highest standards in government accounting and financial reporting.



President

Executive Director

PRINCIPAL ORGANIZATIONS AND KEY OFFICIALS

